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Supreme Court of the United States.

OCTOBER TERM, 1976.

No. 1197.

SECURITIES INVESTOR
PROTECTION CORPORATION,
PETITIONER,
v.
MASSACHUSETTS FINANCIAL SERVICES, INC.,
RESPONDENT.

Brief of Respondent in Opposition to the Petition for a Writ of Certiorari to the United States Court of Appeals for the First Circuit.

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RESPONDENT.

Brief of Respondent in Opposition to the Petition for a Writ of Certiorari to the United States Court of Appeals for the First Circuit.

This brief is submitted on behalf of Respondent Massachusetts Financial Services, Inc. ("MFS") in opposition to the Petition for a Writ of Certiorari to review the judgment of the Court of Appeals for the First Circuit entered on December 1, 1976. Respondent respectfully submits that the Petition should be denied on the grounds that this case was properly decided by the Court of Appeals and does not involve an important question of federal law which should be settled by this Court.

Statutory Provisions Involved.

Section 3(a) of the Securities Investor Protection Act (SIPA)[1] provides, in pertinent part:

> (a) Creation.—There is hereby established a body corporate to be known as "Securities Investor Protection Corporation" (hereafter in this chapter referred to as "SIPC"). SIPC shall be a nonprofit corporation and shall have succession until dissolved by act of the Congress. SIPC shall—
>
> . . .
>
> (2) be a membership corporation the members of which shall be—
>
> (A) all persons registered as brokers or dealers under section 15(b) of the 1934 Act, and
>
> (B) all persons who are members of a national securities exchange,
>
> other than persons whose business as a broker or dealer consists exclusively of (i) the distribution of shares of registered open end investment companies or unit investment trusts, (ii) the sale of variable annuities, (iii) the business of insurance, or (iv) the business of rendering investment advisory services to one or more registered investment companies or insurance company separate accounts . . . .

Section 2 of SIPA provides, in pertinent part:

> Except as otherwise provided in this chapter, the provisions of the Securities Exchange Act of 1934 . . . apply as if this chapter constituted an amendment to, and was included as a section of, such Act.

[1] Pub. L. No. 91-598, §3(a), 84 Stat. 1637 (1970), 15 U.S.C. §§78aaa *et seq.*

Section 3(a) of the Securities Exchange Act of 1934 ("1934 Act"),[2] 15 U.S.C. §78c(a), provides, in pertinent part:

> When used in this chapter, unless the context otherwise requires—
>
> • • •
>
> (4) The term "broker" means any person engaged in the business of effecting transactions in securities for the account of others, but does not include a bank.
>
> (5) The term "dealer" means any person engaged in the business of buying and selling securities for his own account, through a broker or otherwise, but does not include a bank, or any person insofar as he buys or sells securities for his own account, either individually or in some fiduciary capacity, but not as a part of a regular business.
>
> • • •

Question Presented for Review.

Section 3(a) of SIPA establishes the Securities Investor Protection Corporation ("SIPC") and provides that its members shall include all exchange members and brokers or dealers registered under the 1934 Act, except those "whose business as a broker or dealer" consists exclusively of certain enumerated lines of business, including "the distribution of shares of registered open end investment companies [mutual funds] . . . ." This case concerns the interpretation of the words "business as a broker or dealer" as used in section 3(a)(2) of SIPA and presents for review

[2] 15 U.S.C. §§78a *et seq.*

the question whether an investment adviser which registers as a broker-dealer under the 1934 Act solely for the purpose of distributing the shares of the mutual funds it advises is exempt from SIPC membership because its "business as a broker or dealer" consists exclusively of "the distribution of shares of registered open end investment companies [mutual funds] . . . ."

Statement of the Case.

The Facts

MFS is a Massachusetts corporation which from its incorporation in 1969 until 1973 was exclusively engaged in business pursuant to its registration under the Investment Advisers Act of 1940 ("Advisers Act").[3] Until 1973, MFS was organized into two divisions, the Investment Counsel Division and the Mutual Fund Division. The Investment Counsel Division provides advice to private clients whose funds and securities are held and transferred by third persons unaffiliated with MFS, and the Mutual Fund Division provides investment management services to six mutual funds. Until 1973, MFS conducted no business requiring it to register as a broker-dealer under the 1934 Act. In December, 1972, however, MFS registered under the 1934 Act as a broker-dealer exclusively for the purpose of distributing through its newly formed Sales Division the shares of mutual funds it advised. Since that time MFS has conducted no other business which would require it to register under the 1934 Act or which would result in its being a broker or dealer as those terms are defined in the 1934 Act, although it has continued to conduct its principal business as an investment adviser.

[3] 15 U.S.C. §§80b-1 *et seq.*

Reasons for Denying the Petition.

SIPC's contention that the Court of Appeals' "construction of section 3(a)(2) endangers the funding of the SIPC program and the protection of public investors, and results in uncertainty and conflict in the application of section 3(a)(2)" (Petition, p. 8) is nothing more than an exercise in hyperbole that is belied by the facts.

De Minimus Effect on SIPC

Although SIPC admits that its fund at year-end 1976 was substantial ($116.2 million), it appears to argue that the loss of assessments from MFS (a total of $5,368 in 1972 and 1973) and from two firms with which it is engaged in similar litigation (involving "more than $100,000 aggregate assessments") jeopardizes SIPC's ability to satisfy demands on its fund and to achieve its statutory minimum target of $150 million.[4] Such a proposition not only lacks credibility on its face, but is in direct contradiction to recent statements of Hugh F. Owens, Chairman of SIPC, which make clear that the number of member failures has fallen drastically over the last few years and that SIPC is less than two years away from reaching its $150 million goal, after which a new assessment rate and structure may be adopted:

> *The downward trend in member failures continued in 1976 when only four companies were placed in SIPC liquidation. That is an all-time low, off significantly from eight in 1975 and 15 in 1974. It is a far cry from the high year, 1972, when trustees were appointed for 40 members.*

[4] It is interesting to note, however, that SIPC has not stated that it considers those two cases to be indistinguishable from the case at bar (Petition, pp. 8-9).

Fewer liquidations is good news for . . . SIPC members who benefit not only from improved public confidence, but also from a reduction in SIPC's expenses.

With the declining number of new cases, the cost of SIPC's operations has gone down significantly . . . . Less money was needed to satisfy a small number of claims in new cases and most of the claims in older cases have, of course, been satisfied for some time . . . Net growth of the SIPC Fund during the year was $34 million, resulting in a Fund balance of $116 million as of December 31, 1976. This is the largest annual increase in SIPC's history and is a healthy growth indeed.

The principal source of SIPC Fund revenues is the assessments on members. *The current rate of 1/2% on gross securities business revenues is mandated by the 1970 Act and must remain in effect until the Fund reaches $150,000,000, completing the build-up phase. At that time, which we estimate will be sometime in 1978, SIPC may change the assessment rate.*

In September I named a Special Task Force to consider the future assessment rate and structure . . . .

SIPC is in good shape after six years of operations. The Fund is growing. Improved regulatory procedures have been implemented by the self-regulatory organizations and the SEC. *The number of broker-dealer failures resulting in SIPC liquidations continues to decline,* making lower operating costs possible. *In short, SIPC is meeting the purpose for which it was intended*—to give greater protection to the investing public. 6 SIPC Ann. Rep. 4-5 (1976).[5] (emphasis added)

[5] In is interesting to note that although the 1976 annual report referred to the Court of Appeals' decision in this case, it did so without discussing its alleged significance. *See* 6 Sipc Ann. Rep. 11 (1976).

In light of the above, SIPC's contention that the Court of Appeals' decision "can only draw federal exposure [funding] closer" (Petition, p. 10) is particularly disingenuous.

No Conflict Exists

SIPC's "bootstrap" argument that this Court should review the Court of Appeals' decision because of the "conflict" or "lack of uniformity" that would result from SIPC's refusal to follow the Court of Appeals' decision in other circuits is equally without substance. Obviously, in light of the absence of a conflicting decision in another circuit, the only possible "conflict" that could exist would be one of SIPC's own making, involving SIPC's contentions as a litigant, on the one hand, and the unanimous decision of the Court of Appeals on the other. Unlike a conflict between decisions of two or more Circuit Courts, a "conflict" involving nothing more than a difference of opinion between a private litigant who has had his day in court and a Court of Appeals should not be a basis for review by this Court. It is therefore respectfully submitted that this Court should await the decisions in the two similar cases pending in other circuits (Petition, p. 8) before giving further consideration to a review of the question presented here.

The Decision Will Not Result in Administrative Burdens

SIPC's statement that the Court of Appeals' decision will result in possible "administrative difficulties in the First Circuit" (Petition, p. 9) is not only based upon an argument which the Court of Appeals clearly rejected (namely that section 3(a)(2) and section 4(i)(1) are interrelated),[6] but obscures the fact that the only inquiry

[6] Even SIPC acknowledges this fact later in its Petition: "The Court of Appeals appears to have considered Section 3(a)(2) as a membership provision unrelated to its function as part of the funding mechanism of SIPA." (Petition, pp. 15-16).

which must be made in determining if a firm is exempt from SIPC membership is whether a prospective member's traditional broker-dealer activities are limited to the lines of business enumerated in section 3(a)(2).

THE DECISION WILL NOT AFFECT CUSTOMER PROTECTION.

Relying as it so often does on words like "indeterminable" and "imponderable", SIPC gives the misimpression that the Court of Appeals' decision may preclude customers of firms like MFS from receiving the protections of SIPA:

> "Just how far the rationale of the Court of Appeals will adversely affect the public is an imponderable . . . (Petition, p. 10).

That this "argument" is nothing more than a "red herring" is clear from the fact that even if MFS were a member of SIPC, it would not have customers who would be entitled to the protections of SIPA, as MFS sells only to broker-dealers and therefore does not hold cash or securities of the investing public. *See* section 5(a)(2) of SIPA and *Securities and Exchange Commission v. F.O. Baroff Co., Inc.*, 497 F.2d 280 (2d Cir. 1974).

In short, it should be clear that SIPC has failed to meet its burden of establishing that the Court of Appeals' decision involves "an important question of federal law which has not been, but should be, settled by this court . . . ." Rule 19 of the Rules of the Supreme Court of the United States.

Argument.

THIS CASE WAS PROPERLY DECIDED BY THE COURT OF APPEALS.

Enacted by Congress in 1970 in the wake of the failure or financial instability of a considerable number of

brokerage firms, SIPA established SIPC, a nonprofit membership corporation, for the principal purpose of "providing financial relief to the customers of failing broker-dealers with whom they had left cash or securities on deposit". *Securities Investor Protection Corporation v. Barbour,* 421 U.S. 412, 413 (1975). To accomplish this purpose, SIPA requires SIPC to establish a fund by imposing assessments upon its members, who, under section 3(a)(2) of SIPA, are:

> "(A) all persons registered as brokers or dealers under section 15(b) of the 1934 Act, and
>
> "(B) all persons who are members of a national securities exchange,
>
> other than persons whose *business as a broker or dealer* consists exclusively of (i) the distribution of shares of registered open end investment companies or unit investment trusts, (ii) the sale of variable annuities, (iii) the business of insurance, or (iv) the business of rendering investment advisory services to one or more registered investment companies or insurance company separate accounts . . . ." (emphasis added)

It is MFS' position, upheld by both the District Court and the Court of Appeals, that because the only business which it conducts pursuant to its 1934 Act broker-dealer registration, and/or which results in its being a broker or dealer within the ordinary, traditional and defined meaning of those words, is its distribution of mutual fund shares through its Sales Division, all of its business "as a broker or dealer" falls squarely within the exempting language of subparagraph (i) of section 3(a)(2) such that it is not a member of SIPC. SIPC, however, disagrees with MFS' position on the ground

that Congress did not use the words "broker or dealer" in the sense that those terms have traditionally been used in the securities laws and industry, but rather intended to give those words the novel meaning of "securities business." From this implausible premise, SIPC argues that because MFS conducts business pursuant to its Advisers Act registration in addition, although unrelated, to the "exempt" broker-dealer business for which it registered, its "business as a broker or dealer" does not exclusively consist of the enumerated lines of "exempt business". The question presented, therefore, is whether MFS is a "broker or dealer," not because of its "exempt" broker-dealer business, but because of its unrelated investment advisory business which does not require registration under the 1934 Act or make MFS a "broker" or "dealer" in the traditional, ordinary or defined sense of those words.

As the Court of Appeals stated, "[t]he words 'broker' and 'dealer' have highly technical meaning in securities law; if Congress had not intended these words to have their usual technical sense, it could very easily have found appropriate language to so indicate. *Local 1424, Int'l Ass'n of Machinists v. NLRB,* 362 U.S. 411, 417 n.7, 80 S.Ct. 822, 4 L.Ed.2d 832 (1960)". 545 F.2d 754, 756 (footnote 3). Congress' not having done so, the technical and ordinary meaning of "broker" and "dealer" should be given to those words, as Congress is presumed to have used plain language in a statute in its usual and well settled sense, especially where, as here, the statutory language is not only "clear but also . . . produces a result which is neither absurd, unreasonable nor at variance with the policy of SIPA."[7]

[7] The inclusion in section 3(a)(2) and section 4(i)(1)'s exempting language of "the business of insurance" and "the rendering of investment advisory services" was clearly a result of "legislative overkill" in response to requests from the insurance and mutual fund industries wanting to make absolutely certain that they would not be subject to SIPC membership and assessments. For example, prior to 1970 a substantial number of insurance companies began marketing variable annuities or mutual funds as broker-dealers, and registered under the 1934 Act for that purpose. *See SEC v. Variable Annuity Life Insurance Company of America,* 359 U.S. 65 (1959). Although such insurance companies would be clearly exempt from membership and assessments under the mutual fund and annuity exempting language of section 3(a)(2) and section 4(i)(1), the insurance industry sought the additional "business of insurance" exemption to make certain that someone like SIPC with a creative imagination would not argue that their non-broker-dealer business somehow made them subject to membership or assessment. The exemption for "the rendering of investment advisory services" was similarly added. Although these additions may well involve "superfluous verbiage" (Petition, p. 15), they were inserted to "prevent" SIPC from doing exactly what it is seeking to do in this case.

545 F.2d 754, 756. *See Banks v. Chicago Grain Trimmers,* 390 U.S. 459, 465 (1968); *Flora v. United States,* 357 U.S. 63, 65 (1968); *United States v. Oregon,* 366 U.S. 643, 648 (1961); *United States v. Stewart,* 311 U.S. 60, 63 (1940); and *United States v. American Trucking Ass'ns., Inc.,* 310 U.S. 534, 543 (1940).

This rule of construction applies with all the more force in this case where section 2 of SIPA provides:

> "Except as otherwise provided in this chapter, the provisions of the Securities Exchange Act of 1934 . . . apply as if this chapter constituted an amendment to, and was included as a section of, such Act."[8]

Section 3(a) of the 1934 Act, 15 U.S.C. §78c(a), provides, in pertinent part:

[8] It is interesting to note that SIPC seeks to rewrite not only section 3(a)(2), but also section 2 of SIPA: "SIPA is not an amendment to the 1934 Act . . ." (Petition, p. 14, footnote 13).

"(4) The term 'broker' means any person engaged in the business of effecting transactions in securities for the account of others, but does not include a bank."

"(5) The term 'dealer' means any person engaged in the business of buying and selling securities for his own account, through a broker or otherwise, but does not include a bank, or any person insofar as he buys or sells securities for his own account either individually or in some fiduciary capacity, but not as a part of a regular business."

As it should be assumed that Congress intends the definition of a word to apply to that word wherever it is used in a statute, the above definitions of "broker" and "dealer" clearly should apply to those terms as they are used in section 3(a) of SIPA. *See*, for example, *Patagonia Corporation v. Board of Governors of the Federal Reserve System*, 517 F.2d 803, 810 (9th Cir. 1975). Moreover:

"it is well settled that, absent evidence to the contrary, words or phrases taken from prior legislation will be given the same meaning, since there is hardly a basis for assuming that the lawmakers had anything else in mind. This consideration is even more compelling where, as here, the provision containing the word in question is part of a statute that is merely a continuation of earlier legislative schemes."[9] *United Shoe Workers of America, AFL-CIO v. Bedell*, 506 F.2d 174, 183 (D.C.Cir. 1974), citing *Hynes v. Grimes Packing Co.*, 337 U.S. 86, 116

[9] *See also* section 80b-2(3) and (7) of the Advisers Act where the terms "broker" and "dealer" are similarly defined.

(1949) and *United States v. CIO*, 335 U.S. 106, 112-113 (1948).

Thus, by using the words "broker or dealer" (which have not only well settled meanings within the securities industry, but also clearly defined meanings in related securities laws, which meanings SIPA expressly adopts, Congress could not have stated more clearly its intention to exempt from SIPC membership those persons whose business as a traditional broker or dealer consisted exclusively of one or more of the enumerated lines of "exempt business."

SIPC nonetheless attempts to escape the above logic by arguing (Petition, p. 15) that since "the critical phrase does not refer to a broker or dealer registered under the 1934 Act. . . . [c]learly, the language in question was not tied to 1934 Act registration." As is clear from SIPC's Petition, however, the language of section 3(a)(2) was not limited to *registered* broker-dealers because at the time of SIPA's enactment certain broker-dealers (exchange members) were not required to register under the 1934 Act. Thus, in order that SIPA's membership provision (including its exempting language) would apply to all technical broker-dealers, it was necessary for SIPA to include exchange members among SIPC's members:

When SIPA was enacted, exchange members could, under certain circumstances, *do business as a broker or dealer* without being registered under the 1934 Act. II L. Loss, Securities Regulation 1289 (2d. ed. 1961). (Petition, p. 15) (emphasis supplied)

Accordingly, it is clear that when Congress used the terms "broker" and "dealer" in section 3(a)(2), it intended those terms to have their traditional and ordinary

meanings applicable to both SIPC's registered and non-registered broker-dealer members.

Although SIPC also argues that the Court of Appeals' decision results in a "conflict" between SIPA's membership and assessment provisions (Petition, p. 17), the only "conflict" that in fact exists is between SIPA, as enacted by Congress, and SIPC's proposed statutory scheme, which, however logical SIPC may think it is, Congress did not enact.[10] Moreover, SIPC's argument that the membership and assessment provisions must be read together not only requires one to ignore completely the words "broker or dealer" used in the membership provision, but also would, if accepted, not result in MFS' being a member of SIPC. The assessment provision obviously has as its aim the assessment of all of a member's non-exempt securities business that is *integrally* related to its trading or dealing in securities *in its capacity as a broker or dealer*, even though the conduct of some of that business in and of itself would not be sufficient to make that person a broker or dealer. Although resort to the legislative history is unnecessary for this conclusion, it is interesting to note the following statements referred to, in part, in SIPC's Petition:

> "Regarding the inclusion in assessable gross revenues of fees for mutual-fund-related investment advice, management and account supervision, it was the SEC's view that *such revenues 'are integral parts of the broker-dealer business'* which should be assessed . . . (footnote 50) . . . 'First such activity tends to generate additional securities business, and *brokers supplying such services* are dependent upon the maintenance of investor confidence . . . Second, *commission income* is often set off against investment advisory fees which *brokerage houses charge* (NYSE Rules 440.00). This, of course, creates a direct financial connection between such services and *commission income.*' " (emphasis added)[11]

Given this purpose and the fact that MFS' exempt broker-dealer activities are unrelated to the only other activity referred to in section 4(i)(1) that it conducts, that of rendering investment advice, it is clear that MFS should not be subject to assessment by or membership in SIPC even if the assessment and membership provision of SIPA were viewed as being interrelated.

Not only the plain wording of section 3(a)(2), but also SIPA's overall statutory scheme clearly reveals Congress' intent that only traditional brokers and dealers and not investment advisers or all firms in or related to the securities industry be SIPC members and subject to assessment. For example, SIPA's liquidation procedures concern only failing broker-dealers and their customers who have entrusted cash or securities to them (*SEC v. Baroff, Inc., supra*; *SEC v. Kenneth Bove & Co., Inc.,*

[10] SIPC's reliance on *Henry C. Coppelt dba May Pac Management Co.*, [1973-1974 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 79,814 (SEC 1974), for the proposition that "the SEC staff has construed section 3(a)(2) in the manner urged by SIPC" is a result of its misreading of that statement, as is evident from its failure to italicize the determinative language therein which supports MFS' position:

> "Similarly, your membership in SIPC is required by the Securities Investor Protection Act of 1970 which provides that SIPC's membership shall consist of all registered brokers and dealers and all members of national securities exchanges except those who deal exclusively in mutual funds, variable annuities, the business of insurance or the rendering of investment advice to investment companies or insurance company separate accounts. *If your activities as a broker* are not confined to the exceptions stated, you are required to pay the applicable SIPC assessments." Id. at 84,201-202 (emphasis added)

[11] Petition, p. 19; Senate Hearings, discussed *infra*, at 280-1.

378 F. Supp. 697 (S.D.N.Y. 1974), and section 10(b) makes it unlawful for "brokers or dealers", not all persons in the securities industry, to engage "in business as a broker or dealer" after the appointment of a trustee. It should also be noted that section 7(d) of SIPA amended §78*o* of the 1934 Act to provide for the promulgation of regulations relating solely to:

> ". . . the financial responsibility and related practices of *brokers and dealers* including, but not limited to, [regulations concerning] *the acceptance of custody and use of customers' securities, and the carrying and use of customers' deposits or credit balances.* Such rules and regulations shall require the maintenance of reserves with respect to customers' deposits or credit balances, as determined by such rules and regulations." (emphasis added)

Because MFS' broker-dealer activities are limited to its "exempt" distribution of mutual fund shares, and because MFS' investment advisory clients, who do not deposit cash or securities with MFS, are neither threatened with the risk addressed by SIPA nor able to benefit by SIPA's liquidation procedures, MFS is clearly not one of the persons Congress intended to be a member of SIPC.

That only traditional broker-dealers and not investment advisers were intended to be SIPC members is also obvious from the fact that although MFS conducted the very same "securities business" as an investment adviser prior to its broker-dealer registration that SIPC now claims makes it a broker-dealer, MFS was not required to become a member of SIPC. To argue, as SIPC does, that because MFS registered as a broker-dealer, even though that registration was solely for the purpose of conducting "exempt business," MFS is a broker-dealer for all purposes, including the rendering of investment advice totally unrelated to any of its exempt broker-dealer activities,[12] not only forces an absurd construction on section 3(a), but also elevates form over substance. This is so because investment advisers who separately incorporate their mutual fund distribution operations, as many do, are not subject to SIPC membership, while firms like MFS whose distribution operations are independently conducted through a separate, although not incorporated, division would be subject to SIPC membership. Obviously, Congress could not have intended such an absurd result. Rather, by using the words "business as a broker or dealer" in section 3(a)(2), it intended to avoid such a result.

Legislative History

Although, as the Court of Appeals properly held, resort to legislative history is unnecessary in this case,[13] a review of the legislative history reveals its clear support of MFS' position herein.[14] For example, the House Report of the Interstate and Foreign Commerce Committee No. 91-1613, 91st Cong., 2d Sess. (1970) ("House Report"), states the purpose of SIPA:

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[12] It is clear that MFS' investment advisory business does not require registration under the 1934 Act or result in its being a broker or dealer in the usual and defined sense of those words. *First Atlantic Investment Advisory Corp.*, [1973-1974 Transfer Binder] CCH Fed. Sec. L. Rep. ¶79,746 (SEC 1974).

[13] The Court of Appeals nonetheless reviewed the legislative history "with care" 545 F.2d 754, 757.

[14] SIPA evolved from three bills: H.R. 18109, 91st Cong., 2d Sess. (1970), sponsored by the securities industry's task force ("the industry's bill"); H.R. 18081, 91st Cong., 2d Sess. (1970), sponsored by the SEC ("the SEC's bill"); and H.R. 18458, 91st Cong., 2d Sess. (1970), sponsored by both the SEC and the industry.

"The primary purpose of the reported bill is to provide protection for investors if the broker-dealer with whom they are doing business encounters financial troubles." *3 U.S. Cong. & Admin. News,* 91st Cong., 2d Sess. 5255 (1970).

The House Report goes on to state:

"Membership in the corporation would consist of all brokers and dealers registered under Section 15(b) of the Securities Exchange Act of 1934 and all persons who are members of a national securities exchange, except those persons *whose business as a broker or dealer* consists exclusively of the distribution of shares of mutual funds or variable annuities, would not be included in membership." *3 U.S. Cong. & Admin. News,* 91st Cong., 2d Sess. 5258 (1970) (emphasis added)

The legislative history also reveals that the exemption in question was based upon the fact that the distribution of mutual fund shares did not involve the risk to the public that SIPA addressed. For example, in discussing the SEC's bill, which provided for SEC exempting authority,[15] then SEC Chairman Budge clearly stated that the absence of risk to the public would be *the* factor in exempting broker-dealers from SIPC's coverage:

"Mr. Budge. *I think there would be but one standard, and that would be whether or not the public was at risk. If the public were not at risk, the Commission would exempt the individual firm or class of firms.*

Mr. Focht. But I gather you are saying that that standard should not be written into the act, or should not be in the bill?

[15] H.R. 18081, 91st Cong., 2d Sess. (1970) §2.

Mr. Budge. We certainly have no difficulty with writing it in, *but it seems to me it is implicit that the Commission would not wish to keep in the insurance program firms where there was no risk to the public.*" Hearings on H.R. 13308, H.R. 17585, H.R. 18081, H.R. 18109 and H.R. 18458 Before the Subcomm. On Commerce and Finance of the House Comm. on Interstate and Foreign Commerce, 91st Cong., 2d Sess., 308 (1970) ("House Hearings") (emphasis added).

Although later in the House Hearings Mr. Budge indicated there would be "no *flat* exemptions" based upon risk to the public (House Hearings at 335), it is clear from his remarks that the lack of such risk was to be the determinative factor in granting exemptions under the SEC's bill.[16] Mr. Budge's testimony during the Senate Hearings was to the same effect:

"... the Commission felt that in the first instance it should cover the entire community everyone who is in the securities business, and then under this legislation the Commission is given *broad exemptive powers which I would anticipate it would use to exempt out people who do not actually create a risk.*" (Senate Hearings at 282) (emphasis added)[17]

[16] Mr. Budge indicated during the Senate hearings, for example, that because specialists are such an "integral part of the securities business," they would not be exempted from SIPC membership even though they posed no risk to the public. Hearings on S. 2348, S. 3988, S. 3989 Before the Subcommittee on Securities of the Senate Committee on Banking and Currency, 91st Cong., 2d Sess. 281 (1970) ("Senate Hearings").

[17] In discussing the SEC bill's exempting provision, Mr. Budge also stated:

"The intention was, I think, throughout, to include the entire family of the securities industry, and then the Commission is given *very broad powers to exempt out those where it feels there is no public exposure.*" (House Hearings at 334) (emphasis added)

Mr. DeNunzio, Chairman of the industry task force, was the chief industry spokesman with respect to the industry's bill, which also provided for SEC exempting authority. Mr. DeNunzio clearly stated the industry's intention that exemptions be based on lack of risk to the public:

> "Mr. Focht. Turning to the proposal itself, Mr. DeNunzio, I notice in the new section 13 which would be added to the 1934 Act, you provide that the Securities and Exchange Commission may grant exemptions from membership in SIPC or a comparable organization.
>
> "What type of exemptions do you contemplate?"
>
> "Mr. DeNunzio. *I think the SEC would consider making exemptions to certain broker/dealers who do not carry any customer accounts. For example, those who do essentially a cash business, and make direct mutual fund sales, distributing operations, so that they do not carry any customer accounts of any kind.*
>
> *"I would think that the SEC might consider that those kinds of broker/dealers could be exempted from SIPC.*
>
> "Mr. Focht. If I understand the section correctly, it would be the SEC's determination on that question?
>
> "Mr. DeNunzio. That's right." (House Hearings at 186) (emphasis added).[18]

[18] *See also,* "Statement of Robert L. Augenblick, President, the Investment Company Institute":

> "We also believe in the principle that the cost of the insurance should be borne by those who create the risk. For this reason, *we urge that the insurance proposal ultimately adopted should contain a statutory exemption from mandatory participation for those broker-dealers who do not hold and utilize in their own business the customers' free credit balances and customers' securities. The justification for this exemption would be that the exempted broker-dealer's business is not the type that presents the risks that the insurance proposal is designed to guard against."* (House Hearings at 308); and

"Statement of American Life Convention and Life Insurance Association of America", which prompted the variable annuity and insurance "exemptions":

> "The risks at which the bills are directed arise only in the case of those broker-dealers who hold and use customers' free credit balances and customers' securities in their own operations. There are a number of broker-dealers – including life insurance companies (or their subsidiaries) which market variable annuities and mutual funds – which do not operate in this fashion. These broker-dealers should not be required to finance a program for others – they should not be forced to pay for a program which they and their customers do not need and from which they and their customers derive no benefit." (House Hearings at 399)

In light of the above, MFS is confounded by SIPC's misstatement that under both the SEC and industry's bills "risk to the public was merely a factor in determining appropriate assessments." (Petition, p. 19). This misstatement is particularly egregious in light of statements made by SIPC's Chairman and SEC Commissioner Loomis during Congressional hearings on proposed amendments to SIPA, which make abundantly clear that the exempting language in question in this case was adopted based on the absence of risk that firms like MFS pose to the public. For example, Mr. Owens, Chairman of SIPC, stated:

> "Firms dealing exclusively in the sale of mutual funds or variable annuities are not now required to be SIPC members. Their exclusion is apparently *based,* at least in part, *on the argument* that since they are essentially sales organizations, not carrying customer accounts and generally not holding securities or funds, *they present no risk to the SIPC Fund."* Hearings on H.R. 8064 Before Subcomm. on Consumer Protection and Finance of the Comm. on Interstate and Foreign Commerce, House of Representatives, 94th Cong., 1st

Sess. (1975), p. 57 ("House Amendment Hearings") (emphasis added)

Similarly, SEC Commissioner Loomis, who had participated in the Congressional hearings on SIPA, stated:

> "The exclusion of these broker-dealers [exempted under section 3(a)] was *prompted by the idea* that, because they rarely held customers' funds or securities, *their customers did not need SIPC protection* and, therefore, they should not have to pay SIPC assessments." (House Amendment Hearings at 163). (emphasis added)

It is interesting to note that Mr. Loomis went on to point out, contrary to SIPC's contentions, that the membership provision was not meant to be a function of the assessment provision:

> "Once this was done [the exemption of distributors of mutual fund shares, etc.], it was deemed necessary to exclude revenues from the same source as a basis for SIPC assessments on broker-dealers who were members of SIPC, in order to avoid creating a competitive inequality between members and nonmembers in these fields." (House Amendment Hearings at 163).[19]

The above legislative history makes clear that although in enacting SIPA Congress did not allow for the broad ex-

[19] SIPC's almost exclusive reliance on passages from the House Report (Petition, pp. 22-23) for its contrary view is misplaced, as it is obvious that those passages were merely less carefully worded than the passage from the House Report cited *supra* at p. 18. Moreover, the Committee's apparent lack of concern *in the context of the assessment provisions* over whether or not the "exempt activities" were broker-dealer activities is not surprising, for the assessment provisions allow for assessments on certain activities which, although integrally related to a broker-dealer's business, do not involve technical broker-dealer functions. It is, however, interesting to note that in its Petition SIPC stopped immediately short of the House Report's explanation of why it was removing from the assessment provisions revenues from the distribution of mutual fund shares and variable annuities:

> ". . . your committee was of the opinion that there are found on both sides of these transactions persons in the status of investors rather than an investor and a person who is an operator within the market fraternity—that is, one who depends upon the operations of the market and benefits substantially by a healthy and viable marketplace." (House Report at 7)

emptions based upon lack of risk to the public that were contemplated by the SEC and industry's bills, it did provide for the limited exemption, applicable here, of firms like MFS based upon the fact that their traditional or technical broker-dealer activities were limited to the distribution of mutual fund shares involving no risk to the public. Accordingly, the words "business as a broker or dealer" as used in section 3(a)(2) in relation to the "mutual fund exemption" should be read so as to exclude MFS from SIPC membership. To hold otherwise would thwart Congress' intent in enacting the exemption and have the unintended effect of broadening SIPC's membership to include not only traditional broker-dealers, but also traditional investment advisors.

Conclusion.

For the foregoing reasons, it is respectfully submitted that the Petition should be denied and that Respondent should be awarded its costs.

Respectfully submitted,

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